United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

Original

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77-7183

United States Court of Appeals

FOR THE SECOND CIRCUIT

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—against—

TOUCHE ROSS & Co.,

Defendant-Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK
AND ON REMAND FROM THE UNITED STATES SUPREME COURT

TRUSTEE'S BRIEF ON APPEAL

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UNITED STATES COURT
OCT 0 3 1979
SECOND CIRCUIT

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Docket No. 77-7183

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

-against-

TOUCHE ROSS & CO.,

Defendant-Appellee.

On Appeal From The United States District Court
For The Southern District Of New York
And On Remand From The United States Supreme Court

TRUSTEE'S BRIEF ON APPEAL

PRELIMINARY STATEMENT

This brief is submitted by plaintiff-appellant Edward S. Redington, Esq. (the "Trustee") as trustee for the liquidation of the business of Weis Securities, Inc. ("Weis"), pursuant to this Court's letter request of September 12, 1979. This case arises from the Trustee's appeal from an order of the

Honorable Inzer B. Wyatt, United States District Judge, dismissing this action and each claim for relief pleaded by the Trustee for lack of subject matter jurisdiction. Judge Wyatt's opinion is reported at 428 F. Supp. 483 (S.D.N.Y. 1977).

The issues to be resolved at this time concern the scope of the District Court's summary and plenary jurisdiction as a Court of Bankruptcy under provisions of the Bankruptcy Act incorporated into the Securities Investor Protection Act of 1970, 15 U.S.C. §§ 78aaa et seq. (the "1970 Act"). These issues were previously raised in this Court by the Trustee when Judge Wyatt's order was first appealed, but this Court declined to reach them in its initial decision which held that a separate basis for jurisdiction existed under Section 17 of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a et seq. (the "Exchange Act"). The prior decision of this Court is reported at 592 F.2d 617. A determination of these issues is now necessary in light of the Supreme Court's remand of this case following its reversal on the Section 17 question. The Supreme Court's opinion is reported at 99 S. Ct. 2479.

STATUTES INVOLVED

Sections 2a(7), 23, 68a, 102 and 115 of the Bankruptcy Act, 11 U.S.C. §§ 11a(7), 46, 108a, 502 and 515, and Sections 5(b)(2), 6(b)(1) and 6(c)(1) of the 1970 Act, 15 U.S.C. §§ 78eee(b)(2), fff(b)(1) and fff(c)(1) as in force

when this action was commenced are set forth in relevant part in an addendum hereto.[1]

ISSUES PRESENTED FOR REVIEW

1. Whether the District Court had plenary jurisdiction as a Court of Bankruptcy over the Trustee's claims for relief under Section 2a(7) of the Bankruptcy Act?

2. Whether, by filing proofs of claim in a SIPA liquidation proceeding, Touche Ross consented to the summary jurisdiction of the District Court as a Court of Bankruptcy under Section 23b of the Bankruptcy Act as to adverse claims by the Trustee which are reasonably related to Touche Ross' claims, involve overlapping proof and are "mutual" within the meaning of Section 68a of the Bankruptcy Act?

STATEMENT OF THE CASE

This case involves the liability of Touche Ross for an audit of Weis during the spring and summer of 1972. Touche Ross, a firm of certified public accountants, audited Weis and certified the adequacy of Weis' financial statements "as at May 26, 1972." The audit, however, failed to

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1. After this action was commenced, the Securities Investor Protection Act was amended in certain respects in 1978. Pub. L. No. 95-283, 92 Stat. 249 (1978). Where reference is made to the act as it existed before the amendments it is called the "1970 Act." The Bankruptcy Act was also amended in 1978. Pub. L. No. 95-598, 92 Stat. 2549 (1978). References herein to the "Bankruptcy Act" are to that Act as it existed prior to the 1978 amendments.

detect false and fraudulent entries in Weis' books and records, substantial overstatements of Weis' profitability and net worth, and serious misstatements of its net capital ratio. The audit by Touche Ross is alleged to have been at least negligent, if not grossly negligent and reckless, and to have been the proximate cause of a SIPA liquidation in which the Trustee has not been able to make whole all of Weis' customers and creditors.

In the complaint the Trustee has asserted six separate claims for relief. One of these claims, predicated on Section 17 of the Exchange Act (15 U.S.C. § 78q), has been disposed of by the United States Supreme Court. The Trustee's other five claims for relief involve causes of action under state and common law principles of negligence, breach of contract and breach of warranty. Jurisdiction over these non-federal claims was based on principles of pendent jurisdiction and on the summary and plenary jurisdiction of the District Court as a Court of Bankruptcy under the 1970 Act and provisions of the Bankruptcy Act incorporated into that Act. The claim of pendent jurisdiction falls with dismissal of the Section 17 claim. The issues that remain to be resolved concern the extent of the District Court's summary and plenary jurisdiction as a Court of Bankruptcy under the 1970 Act.[2]

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2. Eight other claims are asserted by the Trustee's co-plaintiff, the Securities Investor Protection Corporation ("SIPC"). SIPC, however, asserted different jurisdictional bases for its non-federal claims.

The District Court's Jurisdiction As A Court of Bankruptcy

The Trustee had two grounds for invoking the jurisdiction of the District Court as a Court of Bankruptcy. First, the 1970 Act specifically conferred on the District Court the "powers" of a Chapter X court. As provided by Section 2a(7) of the Bankruptcy Act (11 U.S.C. § 11a(7)), a Chapter X court would have plenary jurisdiction over any action commenced by the Trustee in the Southern District of New York, the district where Weis' liquidation is pending.[3]

Second, even if the District Court had not had the full plenary jurisdiction granted to Courts of Bankruptcy in Section 2a(7), Touche Ross consented to the summary jurisdiction of the District Court as a Court of Bankruptcy by submitting two proofs of claim in the Weis liquidation. (Joint Appendix at 293a-96a.) One claim sought a relatively substantial sum of $67,972 for commencing work on Weis' next annual audit in 1973 - an audit which, under normal auditing practices, would begin with the past year's audited statements and workpapers. This proof of claim also sought a modest amount ($7,471) for services performed by Touche Ross at Weis' London and Paris offices.

In the second proof of claim - an apparent priority claim - Touche Ross sought $11,664 for services allegedly

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3. Paragraph 2 of the complaint pleads Section 2a(7) of the Bankruptcy Act as one of the jurisdictional bases for the Trustee's claims.

rendered in connection with the investigation of Weis' books and records conducted in late April and May of 1973 by the Securities and Exchange Commission and the New York Stock Exchange. The bulk of this claim is attributable to meetings with the SEC and the Exchange and "[s]ubstantiation and documentation of alleged fraudulent bookkeeping practices and entries" - the very practices and entries which are the subject of the Trustee's claims against Touche Ross.[4]

The District Court's Treatment Of The Jurisdictional Issues

In March 1977 the District Court dismissed the complaint in its entirety. The District Court rejected perfunctorily the Trustee's argument that the 1970 Act gave it the powers of a Chapter X court, stating simply that "[t]he arguments of the Trustee have been considered but cannot be accepted." 428 F. Supp. at 492. Instead, the District Court ruled that, by virtue of Section 6(c)(1) of the 1970 Act (15 U.S.C. § 78fff(c)(1)), Section 23 of the Bankruptcy Act (11 U.S.C. § 46) must be read into the 1970

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4. Long after this action was filed and objections and counterclaims based in part on the pendency of this action had been asserted against Touche Ross' claims by the Trustee, Touche Ross' claims in the liquidation proceeding were dismissed with prejudice by stipulation and order dated March 5, 1979. The stipulation and order provide that dismissal of Touche Ross' claims will not affect the Trustee's jurisdictional arguments, including the argument that Touche Ross consented to the jurisdiction of the District Court as a Court of Bankruptcy.

Act as a limitation on the court's bankruptcy jurisdiction. The District Court thus limited its plenary jurisdiction to that of a court supervising a normal bankruptcy rather than that of a court supervising a Chapter X proceeding.

With respect to the Trustee's argument that Section 23 of the Bankruptcy Act was satisfied in any case because of Touche Ross' consent to summary jurisdiction, the District Court held that there was no consent because the claims of Touche Ross and the Trustee were not "mutual" but rather were "unrelated." In reaching this conclusion, the District Court emphasized that portion of the non-priority claim involving services rendered by Touche Ross at Weis' London and Paris branch offices. The Court mentioned only in passing tne $67,972 claim for work commenced on Weis' 1973 audit. The District Court did not even refer to the apparent priority claim in which Touche Ross sought recovery for the steps belatedly taken in April of 1973 to substantiate fraudulent entries - steps which the complaint alleges Touche Ross should have taken in June and July of 1972. Thus, the Court's entire discussion of summary jurisdiction is contained in the following three sentences:

> "* * * [T]he claim filed by Touche in the Weis liquidation was for accounting work in European offices of Weis in late 1972 and early 1973, as well as for a Stock Exchange audit as of April 27, 1973. The claim by the Trustee against Touche does not arise out of any work done for Weis by Touche and for

> which Touche filed a claim in the Weis liquidation. The claims are not 'mutual' therefore but are unrelated and the consent of Touche cannot be found. * * *" (428 F. Supp. at 492 (emphasis in original) (citation omitted).)

The Proceedings In This Court And The Supreme Court

In its decision of April 21, 1978 this Court, reversing in part the District Court's decision, sustained the Trustee's right to maintain an action under Section 17 of the Exchange Act. 592 F.2d 617. The Court declined to pass at that time on the issues regarding the District Court's plenary and summary jurisdiction as a Court of Bankruptcy: "Because of the view we take of the case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA-receivership cases * * *." 592 F.2d at 619 n.3.

Thereafter, Touche Ross filed a petition for a writ of certiorari in the United States Supreme Court seeking, inter alia, review of this Court's decision on the Section 17 claim. As a precautionary measure the Trustee filed a cross-petition for a writ of certiorari seeking review by the Supreme Court of the District Court's disposition of the Trustee's arguments regarding the jurisdiction of the District Court as a Court of Bankruptcy or, in the alternative, remand of the case to this Court for consideration of those issues.

After granting Touche Ross' certiorari petition, the Supreme Court reversed this Court's decision and held that no private right of action could be implied under Section 17. The Supreme Court remanded the case for further proceedings consistent with its opinion. 99 S. Ct. 2479. Subsequently, the Supreme Court denied the Trustee's cross-petition. 99 S. Ct. 3095. There has thus been no appellate resolution of the issues of summary and plenary bankruptcy court jurisdiction raised by the Trustee.

I.

AS A COURT OF BANKRUPTCY AND CHAPTER X COURT THE DISTRICT COURT HAD PLENARY JURISDICTION OF ALL THE TRUSTEE'S NON-FEDERAL CLAIMS.

The District Court had jurisdiction of the Trustee's five non-Section 17 claims under Section 2a(7) of the Bankruptcy Act (11 U.S.C. § 11a(7)), which was made applicable to SIPC liquidations by Section 5(b)(2) of the 1970 Act (15 U.S.C. § 78eee(b)(2)). These provisions conferred upon a district court supervising a SIPA liquidation under the 1970 Act the full jurisdictional "powers" of a court supervising a Chapter X proceeding.

The District Court never discussed these jurisdictional provisions. 428 F. Supp. at 492. Focusing instead solely on Section 6(c)(1) of the 1970 Act, the

Court concluded that its jurisdiction was limited by Section 23 of the Bankruptcy Act to that of a court supervising ordinary bankruptcy proceedings under Chapters I through VII of that Act.[5] This decision was erroneous because it improperly singled out for consideration Section 6(c)(1) of the 1970 Act, which is not a jurisdictional provision, while overlooking the Act's key jurisdictional provision, Section 5(b)(2).

Section 5(b)(2) of the 1970 Act makes clear that a district court has the same jurisdiction over suits by a trustee as a Chapter X court. In Section 5(b)(2) Congress expressly provided that a court in which a SIPA proceeding is initiated shall have the "powers * * * of a court of bankruptcy and of a court in a proceeding under Chapter X of the Bankruptcy Act." (Emphasis

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5. Section 23 is not referred to anywhere in the 1970 Act, but Section 6(c)(1) of the 1970 Act does refer to sections referred to in Section 102 of the Bankruptcy Act (11 U.S.C. § 502). Section 23 is one such section. Section 23, which applies in bankruptcies under Chapters I through VII, limits the District Court's jurisdiction over an action between a trustee and an adverse party as follows:

> "Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this title had not been instituted, unless by consent of the defendant, except as provided in Sections 96, 107 and 220 of this title." (11 U.S.C. § 46(b).)

added.)[6] By providing the SIPA court with the "power" of a Chapter X court, Congress conferred on SIPA courts the full range of "power" conferred on district courts under the bankruptcy clause in Section 2 of the Bankruptcy Act (11 U.S.C. § 11). This grant includes the plenary jurisdictional "power" exercised in all actions brought by Chapter X trustees. See Williams v. Austrian, 331 U.S. 642 (1947); 6 W. Collier, Bankruptcy ¶ 3.18 (14th ed. 1978)

This grant of "power" to a federal court is a jurisdictional grant. See United Mine Workers v. Gibbs, 383 U.S. 715, 725 (1966); Kendall v. United States ex rel. Stokes, 37 U.S. (12 Pet.) 524, 622-23 (1838); United States ex rel. Rudick v. Laird, 412 F.2d 16, 20 (2d Cir.), cert. denied, 396 U.S. 918 (1969). Article III of the Constitution itself uses the word "power" in this jurisdictional sense. In Williams v. Austrian, 331 U.S. 642 (1947), the Supreme Court noted that the "powers" provision in Section 115 of the Bankruptcy Act (11 U.S.C. § 515) "has been inter-

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6. In Section 6(b)(1) of the 1970 Act (15 U.S.C. § 78fff(b)(1)) Congress augmented and reinforced the grant of "power" to the district courts contained in Section 5(b)(2) by providing a SIPA trustee with all the powers of both a bankruptcy and a Chapter X trustee. See SEC v. Albert & Maguire Securities Co., 560 F.2d 569, 574 (3d Cir. 1977); 3 W. Collier, Bankruptcy ¶ 60.85[2] (14th ed. 1977).

preted as jurisdictional" by the federal courts. Id. at 659-60 n.45. And Section 2b of the Bankruptcy Act refers to the jurisdiction vested in Courts of Bankruptcy by the various subsections of Section 2a - including the plenary jurisdiction created by Section 2a(7) - as "powers."

Nowhere in the 1970 Act did Congress limit the jurisdiction of the federal courts in SIPA liquidations to that of Courts of Bankruptcy as opposed to Chapter X courts. Section 6(c)(1) - the provision relied on exclusively by Judge Wyatt - is plainly not a provision which is intended to define the plenary jurisdiction of the district courts. Rather, it is concerned with the conduct of the "liquidation proceeding" in the bankruptcy court and before the bankruptcy judge. This "liquidation proceeding" is that referred to in Section 6(a) of the 1970 Act (15 U.S.C. § 78fff(a)). The liquidation proceeding involves the bankruptcy judge's exercise of summary jurisdiction over such matters as administrative orders, resolution of claims and distribution of property. The conduct of a liquidation proceeding has nothing to do with the extent of a district court's plenary jurisdiction over suits maintained by the trustee outside of the liquidation proceeding. That jurisdiction is conferred by Section 5(b)(2) of the 1970 Act.

In fact, Section 6(c)(1) of the 1970 Act itself precludes the interpretation that its indirect reference

to Section 23[7] supersedes Section 5(b)(2). Section 6(c)(1) specifies that the provisions of Chapters I through VII and Chapter X to which it refers apply "[e]xcept as inconsistent with the provisions of this chapter." The provisions of Section 23 are inconsistent with the jurisdictional "power" conferred in Section 5(b)(2).

Congress could scarcely have intended that the "power" it expressly conferred in Section 5(b)(2) would be eviscerated by oblique and obscure references to Section 23 in a section of the statute dealing with conduct of liquidation proceedings. Rather, the indirect reference to Section 23 in Section 6(c)(1) must have been intended to clarify the extent of the summary jurisdiction and remedial powers of the bankruptcy court. Despite the broader plenary jurisdiction given the district court over actions by the trustee, the summary jurisdiction and functions of the bankruptcy judge in a SIPA liquidation were intended to remain in general the same as in a bankruptcy proceeding so that the administration of the "liquidation proceeding" would be conducted "as though" it were a bankruptcy. See SEC v. Morgan Kennedy & Co., [1973-1974 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 94,568 (S.D.N.Y. May 20, 1974). Significantly, all of the other

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7. See note on page 10, supra.

provisions referred to in Section 102 of the Bankruptcy Act deal with administrative matters.

In sum, Section 5(b)(2) of the 1970 Act grants the district court supervising a liquidation under the 1970 Act the plenary jurisdiction possessed by Chapter X courts under Section 2a(7) of the Bankruptcy Act. In practice, the district court supervising a 1970 Act liquidation has a "home court" jurisdiction similar to that of a court supervising a federal equity receivership. This jurisdiction is similar to that still enjoyed by district courts supervising liquidations under the National Bank Act, see United States v. Franklin National Bank, 512 F.2d 245 (2d Cir. 1975), a form of liquidation used as a model in the drafting of SIPA and involving the same federal interests. See H.R. Rep. No. 91-1613, 91st Cong., 2d Sess., reprinted in [1970] U.S. Code Cong. & Ad. News 5254, 5255.[8]

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8. Even were Section 6(c)(1) of the 1970 Act to be read as a jurisdictional provision, that section specifically incorporates all of the provisions of Chapter X not inconsistent with the 1970 Act, including Section 115 of the Bankruptcy Act (11 U.S.C. § 515). Section 115 confers on district courts the "home court" jurisdiction of a federal equity receivership court over a plenary action brought by a trustee in the court of his appointment. Such ancillary jurisdiction is also sufficient to support the Trustee's claims in this case. See Williams v. Austrian, 331 U.S. 642, 659-60 & n.45 (1947); Riehle v. Margolies, 279 U.S. 218, 223 (1929); In re Federal Facilities Realty Trust, 220 F.2d 495, 499 (7th Cir. 1955); In re Cuyahoga Finance Co., 136 F.2d 18, 20 (6th Cir. 1943); Warder v. Brady, 115 F.2d 89, 94 (4th Cir. 1940).

II.

THE DISTRICT COURT HAD SUMMARY JURISDICTION OVER THE TRUSTEE'S CLAIMS BECAUSE TOUCHE ROSS CONSENTED TO SUCH JURISDICTION BY FILING TWO PROOFS OF CLAIM IN THE WEIS LIQUIDATION PROCEEDINGS.

Even under Section 23 of the Bankruptcy Act (11 U.S.C. § 46), the District Court had summary jurisdiction over the Trustee's claims against Touche Ross because Touche Ross consented to that jurisdiction by filing two proofs of claim in the Weis liquidation.[9] Both of these claims involve accounting services related to the services performed by Touche Ross in the 1972 audit and challenged in the Trustee's complaint; both claims are logically related to, and involve some of the same documents and evidence as, the Trustee's causes of action for breach of contract, negligence and breach of warranty. Under the applicable decisions in this Circuit, these claims constitute consent by Touche Ross to the jurisdiction of the District Court as a Court of Bankruptcy under Section 23b. E.g., Nortex Trading Corp. v. Newfield, 311 F.2d 163 (2d

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9. Section 23b is a limitation on the broad jurisdiction conferred on district courts as courts of bankruptcy by Congress in Section 2a(7) of the Bankruptcy Act. There is no dispute that a district court supervising a SIPA liquidation has at least the jurisdiction conferred by Section 23b although, as explained above in Point I, Touche Ross does dispute whether the 1970 Act contained a broader grant of jurisdiction to the district court.

Cir. 1962); In re Farrell Publishing Corp., 130 F. Supp. 449 (S.D.N.Y. 1955). Cf. United Artists Corp. v. Masterpiece Productions, Inc., 221 F.2d 213 (2d Cir. 1955).

Moreover, even if a compelling nexus between the claims did not exist, the Trustee's claims and those of Touche Ross would clearly be "mutual" as that term is defined in Section 68a of the Bankruptcy Act (11 U.S.C. § 108a). Under Section 68a and the rationale of the Supreme Court's decision in Katchen v. Landy, 382 U.S. 323 (1966), no greater nexus should be required. See also Cherno v. Engine Air Service, Inc., 330 F.2d 191, 193 (2d Cir. 1964).

A. Consent To Summary Jurisdiction Exists Because Touche Ross' Claims Are Logically Related To The Claims Asserted By The Trustee In The Complaint.

Section 23b of the Bankruptcy Act expressly provides for the granting of summary jurisdiction by consent as follows:

> "Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this title had not been instituted, unless by consent of the defendant * * *." (Emphasis added.)

See Schumacher v. Beeler, 293 U.S. 367 (1934).

The law is clear in this Circuit that, by filing a proof of claim in the Bankruptcy Court, a party consents to that Court's jurisdiction and voluntarily submits to the

Court not only in regard to securing his own relief, but also in regard to any related counterclaims that the Trustee might reasonably raise against him in the same proceeding pursuant to his duty to collect the estate. Chase National Bank v. Lyford, 147 F.2d 273, 277 (2d Cir. 1945); In re Seatrade Corp., 297 F. Supp. 577, 579-81 (S.D.N.Y.), appeal dismissed, 418 F.2d 9 (2d Cir. 1969); In re Ira Haupt & Co., 289 F. Supp. 966, 970-71 (S.D.N.Y. 1968); see Beldock v. Faberge, Inc., 4 Bank. Ct. Dec. 432 (1978) (Bankruptcy Judge Galgay).[10]

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10. The rationale for the rule was explained by the Supreme Court in the leading case of Alexander v. Hillman, 296 U.S. 222 (1935) as follows:

> "* * * By presenting their claims respondents subjected themselves to all the consequences that attach to an appearance * * *.
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> * * *
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> "Respondents' contention means that, while invoking the court's jurisdiction to establish their right to participate in the distribution, they may deny its power to require them to account for what they misappropriated. In behalf of creditors and stockholders, the receivers reasonably may insist that, before taking aught, respondents may by the receivership court be required to make restitution. That requirement is in harmony with the rule generally followed by courts of equity that having jurisdiction of the parties to controversies brought before them, they will decide all matters in dispute and decree complete relief. * * * Distribution may not be made without decision upon the counterclaims. Nothing is more clearly a part of the subject matter of the main suit than recovery of all that to the res belongs. * * *" (Id. at 241-42 (citations omitted and emphasis added).)

As stated by Judge Kaufman in Nortex Trading Corp. v. Newfield, 311 F.2d 163, 164 (2d Cir. 1962):

> "The filing by Nortex of its proof of claim is analogous to the commencement of an action within the bankruptcy proceeding. * * * It has often been recognized that counterclaims by the trustee against a claimant are within the summary jurisdiction of the bankruptcy court. * * * The claimant is deemed to consent to the jurisdiction of the court upon filing its proof of claim. * * *" (Citations omitted.)

Consent to jurisdiction is implied where there is a logical relationship between the transactions or occurrences involved in the respective claims or where the proof will be overlapping. E.g., In re Farrell Publishing Corp., 130 F. Supp. 449, 452 (S.D.N.Y. 1955) ("In effect the [Bankruptcy] Act declares a statutory policy to settle all related claims."); In re Seatrade Corp., supra; In re Ira Haupt & Co., supra. See generally Moore v. New York Cotton Exchange, 270 U.S. 593, 609-10 (1926); United States v. Heyward-Robinson Co., 430 F.2d 1077 (2d Cir. 1970), cert. denied, 400 U.S. 1021 (1971); United Artists Corp. v. Masterpiece Productions, Inc., 221 F.2d 213, 216 (2d Cir. 1955). Both of those conditions are satisfied in this case.[11]

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11. Here, the Trustee invoked the summary jurisdiction of the District Court directly instead of proceeding before the Bankruptcy Judge. Consent to the jurisdiction of a Court of Bankruptcy is consent to the summary jurisdiction of the District Court, not consent solely to the jurisdiction of the Bankruptcy Judge. Cf. Whitney v.

(Footnote continued on following page)

1. The General Estate Claim

Consent to the Trustee's claims clearly appears from the face of Touche Ross' two proofs of claim. Touche Ross' regular proof of claim asks for $75,443, of which the lion's share, some $67,972, is sought for:

> "* * * [S]ervices rendered covering the regular New York Stock Exchange, Inc. audit as of April 27, 1973 for the purpose of examining the Answers to Financial Questionnaire and Statement of Financial Condition as of that date." (294a.)

This claim is based upon the same auditing practices, and preparation of the same kinds of reports, as were involved in the 1972 audit. Under normal auditing practices, the 1973 audit would begin with review and analysis of the figures and workpapers for the 1972 audit.[12]

(Footnote continued from preceding page)

Wenman, 198 U.S. 539, 553 (1905); Chase National Bank v. Lyford, 147 F.2d 273, 277 (2d Cir. 1945); 1 Moore's Federal Practice, ¶ 0.62[3] at 678 (2d ed. 1979). It is the District Court, not the Bankruptcy Judge, that is given summary jurisdiction as a Court of Bankruptcy under Sections 2 and 23 of the Bankruptcy Act; disputes committed to the Bankruptcy Judge are committed to that official only on the theory that the District Court retains direct supervisory control through its power of review. See Bankruptcy Act §§ 2a(10) & 39c (11 U.S.C. §§ 11a(10) & 67c); Bankruptcy Rules 801 & 810; 2A W. Collier, Bankruptcy ¶ 39.21 (14th ed. 1978).

12. Indeed, in performing accounting services for Weis over five years, Touche Ross was under a continuing duty to use the information learned in one of a series of audits to correct prior, misleading certifications in previous audits in the same series. Fischer v. Kletz, 266 F. Supp. 180 (S.D.N.Y. 1967); Bancroft v. Indemnity Insurance Co., 203 F. Supp. 49 (W.D. La.), aff'd mem., 309 F.2d 959 (5th Cir. 1962). See Wilkin v. Dana R. Pickup & Co., 74 Misc. 2d 1025, 347 N.Y.S.2d 122 (Sup. Ct. Allegany Co. 1973).

Documents and information relevant to Touche Ross' claim would thus be relevant to the Trustee's causes of action, especially his cause of action for breach of contract. See Goldberg v. Touche Ross & Co., [1976-1977 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 95,759 (S.D.N.Y. Nov. 9, 1976).

Contrary to the District Court's perfunctory analysis, therefore, the regular proof of claim does not relate predominately to work done overseas; nor does it involve services which are unrelated or even severable from those performed by Touche Ross for Weis in 1972. The services upon which the regular proof of claim was based were an integral part of the ongoing accounting role which Touche Ross had in relation to Weis. Submitting a claim for such services clearly gave the District Court summary jurisdiction to det rmine the Trustee's challenge to the adequacy of the closely related services performed less than a year before.

2. The Apparent Priority Claim

Touche Ross' consent to jurisdiction is unusually evident in this case because, in addition to its regular proof of claim, it also submitted an apparent priority claim for services allegedly rendered for the benefit of the Weis estate - a claim which the District Court overlooked completely in its decision. 428 F. Supp. at 492.

This claim seeks payment of $11,664 "For services rendered for benefit of estate" for:

> "Meetings and conferences with personnel of the New York Stock Exchange, Inc. and the Securities and Exchange Commission;
>
> "Substantiation and documentation of alleged fraudulent bookkeeping practices and entries;
>
> "Confirmation of bank loans and related collateral as of April 13, 1973 applicable to the alleged fraudulent bookkeeping entries." (296a.)

Not only were these services part of the ongoing accounting duties which Touche Ross had with respect to Weis prior to the liquidation, but in the second and third items of this proof of claim Touche Ross sought directly compensation for work done in large part to unravel some of the very same fraudulent bookkeeping entries which the Trustee alleges Touche Ross missed or allowed to be perpetrated in the first place. These services relate directly to the very transactions on which the Trustee's complaint in this action is based. Items which Touche Ross asked to be paid for finding in April of 1973 are those which the complaint alleges Touche Ross failed to find in 1972. The liquidation in which Touche Ross asked for payment is alleged to have been caused by Touche Ross' failure to find these items in a timely manner.

B. Consent To Summary Jurisdiction Exists Because There Is Mutuality Between The Claims Asserted By The Claimant And Those Asserted By The Trustee.

As shown above, the doctrine of implied "consent" as that term is used in Section 23b of the Bankruptcy

Act has been deemed to include the assertion of related claims by the trustee. In some cases, that doctrine has not been extended to include the assertion of unrelated claims by the trustee. The wording of Section 68a of the Bankruptcy Act and the rationale of the Supreme Court's landmark decision in Katchen v. Landy, 382 U.S. 323 (1966), however, strongly support extension of the implied "consent" doctrine to include unrelated claims as long as such claims are "mutual" as that term is used in Section 68a of the Bankruptcy Act (11 U.S.C. § 108a). See also Cherno v. Engine Air Service, Inc., 330 F.2d 191, 193 (2d Cir. 1964).

Claims are "mutual" within the meaning of Section 68 if they are "in the same right and between the same parties, standing in the same capacity." 4 W. Collier, Bankruptcy ¶ 68.04 at 867 (14th ed. 1978); United States v. Roth, 164 F.2d 575, 578 (2d Cir. 1948). That is clearly the case here. Accordingly, the District Court would have summary jurisdiction even if the logical relationship test could not be satisfied.

In Katchen v. Landy, 382 U.S. 323 (1966), the Supreme Court held that, when a creditor submits a claim in bankruptcy, summary jurisdiction exists in the Court of Bankruptcy to order the return of a voidable preference because the determination of whether a claimant has received

a voidable preference is a prerequisite to determining the size and allowability of his claim under Section 57g of the Bankruptcy Act (11 U.S.C. § 93g). The Court reasoned that the determination that there had been a preference would be res judicata in any later plenary suit brought by the Trustee to recover the preference, and therefore concluded that "it can hardly be doubted that there is also summary jurisdiction to order the return of the preference." 382 U.S. at 334. Katchen, however, did not decide whether the same rule applied to other types of claims by a trustee because the petition for certiorari in that case had been limited to the preferential transfer question. Id. at 326.

The rationale applied by the Supreme Court in Katchen logically applies to any "mutual debts" since, under Section 68a of the Bankruptcy Act, such mutual debts must be set off and "the balance only shall be allowed or paid."[13] As with preferences, all mutual claims seemingly must first be determined in order to determine

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13. Section 68 provides in pertinent part as follows:

"Section 68. Set-Offs and Counterclaims.

a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid." (11 U.S.C. § 108a.)

whether any "balance" shall be "allowed" in the bankruptcy or "paid" to the trustee by the claimant. Thus, once a claimant files its proof of claim, summary jurisdiction would have to exist to adjudicate the merits of any mutual claim, even a wholly unrelated claim, as a set-off which would diminish or defeat the creditor's claims. See Conway v. Union Bank of Switzerland, 204 F.2d 603, 607 (2d Cir. 1953); United States v. Roth, 164 F.2d 575, 578 (2d Cir. 1948); 4 W. Collier, Bankruptcy ¶ 68.20[4] at 946 (14th ed. 1978). See also 3 Moore's Federal Practice ¶ 13.19[1] (2d ed. 1979).

As in Katchen, once the merits of the adverse claim have been adjudicated between the parties in a Court of Bankruptcy, that adjudication would be res judicata in any later action brought to recover the balance by which a Trustee's counterclaim exceeded the creditor's original claim. Conway v. Union Bank of Switzerland, supra, 204 F.2d at 607; Schwartz v. Levine & Malin, Inc., 111 F.2d 81 (2d Cir. 1940). There is no more reason than in Katchen, however, why two proceedings rather than one should be necessary to achieve this result. The principle of Katchen v. Landy should logically permit the Court of Bankruptcy to award affirmative recovery to the Trustee in the first instance in cases involving mutual debts and credits as well as preferences.

The District Court apparently believed that mutuality was the controlling standard to be applied to the Trustee's consent argument. 428 F. Supp. at 492. The District Court erred, however, in its application of that standard to this case. Touche Ross' claims and the Trustee's claims are mutual because they are asserted in the same right and between the same parties standing in the same capacity. Thus, application of the Section 68 mutuality standard to the Section 23 consent requirement would clearly justify the District Court's exercise of jurisdiction over the Trustee's claims even if there were no other nexus between these claims and the claims asserted by Touche Ross.

CONCLUSION

For the foregoing reasons, the Trustee's complaint should not have been dismissed for lack of subject matter jurisdiction. The order of the District Court should be reversed and the case remanded for further proceedings.

Dated: New York, New York
October 3, 1979

Respectfully submitted,

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ADDENDUM

Section 2a(7) of the Bankruptcy Act
11 U.S.C. § 11a(7)

§ 11. Creation of courts of bankruptcy and their jurisdiction

(a) The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this title, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, and determine and liquidate all inchoate or vested interests of the bankrupt's spouse in the property of any estate whenever, under the applicable laws of the State, creditors are empowered to compel such spouse to accept a money satisfaction for such interest; and where in a controversy arising in a proceeding under this title an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;

Section 23 of the Bankruptcy Act
11 U.S.C. § 46

§ 46. Jurisdiction of controversies between receivers and trustees and adverse claimants

(a) The United States district courts shall have jurisdiction of all controversies at law and in equity, as distinguished from proceedings under this title, between receivers and trustees as such and adverse claimants, concerning the property acquired or claimed by the receivers or trustees, in the same manner and to the same extent as though such proceedings had not been instituted and such controversies had been between the bankrupts and such adverse claimants.

(b) Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this title had not been instituted, unless by consent of the defendant, except as provided in sections 96, 107, and 110 of this title.

Section 68 of the Bankruptcy Act
11 U.S.C. § 108

§ 108. Set-offs and counterclaims

a. In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid.

b. A set-off or counterclaim shall not be allowed in favor of any debtor of the bankrupt which (1) is not provable against the estate and allowable under subdivision g of section 93 of this title; or (2) was purchased by or transferred to him after the filing of the petition or within four months before such filing, with a view to such use and with knowledge or notice that such bankrupt was insolvent or had committed an act of bankruptcy.

Section 102 of the Bankruptcy Act
11 U.S.C. § 502

§ 502. Application of other provisions

The provisions of chapters 1 to 7, inclusive, of this title shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however*, That section 46, subdivisions (h) and (n) of section 93, section 104, and subdivision (f) of section 110 of this title, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters 1 to 7, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 528 of this title, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 527 or 528 of this title except where an adjudication had previously been entered.

Section 115 of the Bankruptcy Act
11 U.S.C. § 515

§ 515. Same; jurisdiction as in insolvency

Upon the approval of a petition, the court shall have and may, in addition to the jurisdiction, powers, and duties hereinabove and elsewhere in this chapter conferred and imposed upon it, exercise all the powers, not inconsistent with the provisions of this chapter, which a court of the United States would have if it had appointed a receiver in equity of the property of the debtor on the ground of insolvency or inability to meet its debts as they mature.

Section 5(b)(2) of the 1970 Act
15 U.S.C. § 78eee(b)(2)

(b) Court action.—

(2) Exclusive jurisdiction over debtor.—Upon the filing of an application pursuant to subsection (a) (2) of this section, the court to which application is made shall have exclusive jurisdiction of the debtor involved and its property wherever located with the powers, to the extent consistent with the purposes of this chapter, of a court of bankruptcy and of a court in a proceeding under chapter X of the Bankruptcy Act. Pending an adjudication under paragraph (1) such court shall stay, and upon appointment by it of a trustee as provided in paragraph (3) such court shall continue the stay of, any pending bankruptcy, mortgage foreclosure, equity receivership, or other proceeding to reorganize, conserve, or liquidate the debtor or its property and any other suit against any receiver, conservator, or trustee of the debtor or its property. Pending such adjudication and upon the appointment by it of such trustee, the court may stay any proceeding to enforce a lien against property of the debtor or any other suit against the debtor. Pending such adjudication, such court may appoint a temporary receiver.

Section 6(b)(1) of the 1970 Act
15 U.S.C. § 78fff(b)(1)

(b) Powers and Duties of Trustee.—

(1) Trustee powers.—A trustee appointed under section 78eee (b) (3) of this title (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. In addition, a trustee shall have the right—

(A) with the approval of SIPC, to hire and fix the compensation of all personnel (including officers and employees of the debtor and of its examining authority) and other persons (including but not limited to accountants) that are deemed by such trustee necessary for all or any purposes of the liquidation proceeding, and

(B) to operate the business of the debtor in order to complete open contractual commitments pursuant to subsection (d) of this section,

and no approval of the court shall be required therefor.

Section 6(c)(1) of the 1970 Act
15 U.S.C. § 78fff(c)(1)

(c) Application of Bankruptcy Act.—

(1) General provisions applicable.—Except as inconsistent with the provisions of this chapter and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of chapter X and such of the provisions (other than section 96(e) of Title 11) of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive; except that the court may, for such period as may be appropriate, stay enforcement of, but shall not abrogate, the rights provided in section 108 of Title 11 and the right to enforce a valid, nonpreferential lien or pledge against the property of the debtor. For purposes of applying the Bankruptcy Act in carrying out this section, any reference in the Bankruptcy Act to the date of commencement of proceedings under the Bankruptcy Act shall be deemed to be a reference to the filing date (as defined in section 78eee(b) (4) (B) of this title).

STATE OF NEW YORK)
: ss.:
COUNTY OF New York)

AFFIDAVIT OF SERVICE

MARIO A. ROSADO, being duly sworn, deposes and says that he resides at 782 Pugsley Avenue Bronx, New York 10473

; that on the 12 day of July , 1977, he served the within Brief Plaintiff-Appellant, Edward S. Redington, as Trustee

on the attorneys for plaintiff-appelant, Securities Investor Protection Corporation, and for defendant-appellee, Touche Ross & Co.
herein by mailing two true ~~copy~~ copies thereof, securely enclosed in a post-paid, properly addressed wrapper, in the mail box under the exclusive care and custody of the United States Postal Service at the corner of Wall Street and Broadway, New York, New York, addressed to said attorneys as follows:

Clarence Fried, Esq.
HAWKINS, Delafield & Wood
67 Wall Street
New York, New York 10005

Arnold Roth, Esq.
Rosenman, Colin, Freund
Lewis & Cohen
575 Madison Avenue
New York, New York 10022

The above addresses has appeared on the prior papers in this action as the office addresses of said attorney .

Deponent is over the age of 18 years and not a party to this action.

Mario A Rosado

Sworn to before me this
12th day of July , 1977.

John J. Sullivan
Notary Public

JOHN J. SULLIVAN
Notary Public, State of New York
No. 4634702
Qualified in New York County
Commission Expires March 30, 1978

HAWKINS DELAFIELD & WOOD

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ROSENMAN COLIN FREUND LEWIS & COHEN
ATTORNEYS FOR

Dft.
4:05 p.m.